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COMPETITION COMMITTEE**

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Global Forum on Competition

ABUSE OF DOMINANCE IN REGULATED SECTORS

Case submitted by South Africa

-- Session III --

This case is submitted by South Africa in view of its discussion in Sub-Session 2 on Friday 18 February 2005 (from 9.30 am).

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NATIONAL ASSOCIATION OF PHARMACEUTICAL WHOLESALERS AND 8 OTHERS ('THE COMPLAINANTS') V. GLAXO WELLCOME (PTY) LTD AND 6 OTHERS ('THE RESPONDENTS') (68/IR/JUN 00)

1. Introduction

1. This is an application for interim relief by nine wholesale distributors of pharmaceutical products. Five of the respondents are pharmaceutical manufacturers and importers ("the manufacturers") who have established a joint exclusive distribution agency ("EDA") for their products. It is alleged that the manufacturers are in contravention of provisions of the Competition Act that proscribe restrictive horizontal practices (Section 4), restrictive vertical practices (Section 5) and abuse of dominance (Section 8).

2. What follows is essentially an edited excerpt of the Tribunal's decision in this matter. Given the subject matter of this discussion we have only dealt with the allegations concerning restrictive vertical practices and abuse of dominance. The full decision is available on the OECD and the Tribunal web site.

3. The Tribunal's decision to dismiss the application is presently on appeal to the Competition Appeal court. Note that it is an application for *interim* relief and hence it is decided on the basis of the filed papers alone and without the benefit of oral evidence. In the event of a factual dispute, the respondent's version is generally preferred in an application for interim relief.

2. The distribution of pharmaceutical products

4. In South Africa the pharmaceutical wholesalers have traditionally effected the distribution of pharmaceutical products from the manufacturers to the retail pharmacies. That is to say, specialist pharmaceutical wholesalers purchased pharmaceutical products from the manufacturers and then on-sold these to retail pharmacies and other small purchasers. The wholesalers generally received a standard rate of discount of 17,5% off the manufacturers' list price. The wholesalers retained a portion of this discount, the difference between their purchasing price and their selling price constituting their trading margin. The standard range of this trading margin appears to have been approximately 5%-7%. Note that the wholesalers generally trade in all products traditionally available from retail pharmacists including ethical pharmaceutical products, over-the-counter pharmaceutical products and a range of fast moving consumer goods.

5. In March 2000, a number of manufacturers who are the respondents in this matter jointly acquired one of the existing wholesale distributors which they then proceeded to transform into an EDA. The transformation essentially meant that the erstwhile distributor went from being a wholesaler, owning its stock and trading on its own account, to an agency distributor which distributed its principals' stock at an agreed fee. The name of the distributor was changed to Kinesis.

6. The terms of the EDA provided that the respondents would henceforth distribute all of their products through Kinesis alone. This applied to distribution to all of their customers including retail pharmacists, dispensing doctors, hospital groups and the State. Wholesalers, too, would have to acquire their product through the EDA on the same terms and conditions available to the retail trade. In other words, insisted the manufacturers, they were not refusing to supply the wholesalers, but were simply insisting that they receive the product from the EDA, Kinesis, on the same terms and conditions available to the retailers. The wholesalers insisted that the withdrawal of their discount would effectively eliminate

them from the market and accordingly they asked the Tribunal to find a number of anticompetitive practices covering restrictive horizontal and vertical practices and abuse of dominance. They requested an order which would effectively restore the *status quo ante*, in particular that would restore the discounts that distinguished their trading terms from those of their customers, the retailers

7. Note that the wholesalers had never been active in distributing pharmaceutical products to the large hospital groups and the State – these were serviced directly by the manufacturers. After its conversion from a wholesaler into a distribution agent, ownership of the products sold through Kinesis remained with the manufacturer until the sale to the customer. This, we emphasise, contrasts with the wholesale mode of distribution where the wholesaler, a trader, takes ownership of the product from the manufacturer. The wholesaler then on-sells these products to the retailer, in this way effecting the distribution of pharmaceutical products. In addition to the task of physical distribution, Kinesis performs a range of other distribution related services including the taking of orders and collection of payment on behalf of the manufacturers. Kinesis undertakes these services on behalf of each principal in exchange for a fee agreed between each principal and the distribution agent.

8. When this matter was first heard by the Tribunal, the panel upheld the wholesalers on the ground that the *joint* ownership by the manufacturers of the distribution agency contravened the prohibition on restrictive *horizontal* agreements. This finding was taken on review to the Competition Appeal Court which sent the matter back for a further hearing because of substantive and procedural shortcomings associated with the relief imposed by the Tribunal.

9. However by the time the matter came back to the Tribunal the manufacturers – cognisant of the Tribunals' attitude to their joint ownership of the distribution agent – had sold Kinesis to Tibbett and Britten ("T&B"), a UK logistics services provider. The manufacturers maintain that their relationships with their distribution agent are now governed by separate service level agreements concluded between the respective principals and T&B/Kinesis.

10. In the pharmaceutical industry – as with many consumer goods – there are a relatively small number of manufacturers whose products are purchased by the final consumer through a relatively large number of retail outlets. In the case of 'ethical' or patented pharmaceutical products these retail outlets are a myriad of pharmacists or 'chemists'. The manufacturer is thus confronted with the formidable task of ensuring that its product is available in the required quantity and form at the ultimate point of sale. In a word, the manufacturer is confronted with the task of *distributing* its product to the retailers.

11. There are a number of alternative mechanisms for effecting distribution. The manufacturer may simply be approached by the ultimate interface with the final end consumer, that is, the retailer, take orders for the product and arrange for its transportation to these points of retail distribution. Indeed, in the case of very large retailers of pharmaceutical products – these being the large hospital groups, most particularly, although not exclusively, the state hospital services – this is precisely how distribution is effected to this day. In other words, there is, in this important latter segment of the pharmaceutical manufacturing and distribution chain, a direct interface between the manufacturer, on the one hand, and, on the other, the vehicle through which the final end consumer acquires pharmaceutical products. There has been no need, presumably either on the part of the seller or the buyer, for an intermediary between these two ends of the chain and so the wholesale trade, precisely the intermediary between manufacturer and retailer, has largely been absent from this segment.

12. However, there are a large number of consumers of pharmaceutical products who do not procure their medicines by attending a hospital. Instead, they approach, in a manner not fundamentally different to a purchaser of, for example, clothing or grocery products, a high street retailer in order to satisfy their needs. However, unlike in the case of grocery or mass clothing products, and this largely because of

regulatory intervention, the retail pharmaceutical sector is not, at this stage, dominated by increasingly large outlets that are household names as in the area of grocery or clothing retail. Note that the rise of the large retail grocery supermarket chains has all but eliminated the grocery wholesale trade.

13. For a manufacturer, skilled in and focused on the innovation and production process, interfacing with a large number of retailer customers is highly undesirable. It is indeed, albeit for different reasons, no less taxing for a large number of retailers to deal with a small number of producers, particularly in an industry whose peculiar features demand that the retailer stock the product of all or most manufacturers. In other words, the high costs associated with transacting between a small number of manufacturers, on the one hand, and, on the other hand, a large number of retailers – costs borne in various ways by both parties to the transaction - have created an opportunity for a set of traders, the wholesalers, to simultaneously meet the requirements of both the manufacturers and retailers. Naturally, as in any trade, the rise of these intermediaries is accompanied by rules, associations, legislation, venerable firms and the like, by all the trappings of permanency. However, it is essential to understand that the rise of this intermediary trading function, however ordered and permanent it may subsequently appear to be, is rooted in a spontaneous, admirably opportunistic response to a particular set of market conditions and a changed set of market conditions may call forth a different response from the key participants.

14. The wholesaling function is, of course, by no means costless. It requires considerable investment and the investors naturally seek a reward – their decision to direct their resources to pharmaceutical wholesaling is not, after all, driven by commercial considerations, by the reward that the entrepreneurs and investors expect to receive in exchange for meeting a demand generated by market conditions. But they are traders – they seek their reward neither from those from whom they purchase product nor from those to whom they sell product. They garner their reward by buying cheap and selling dear. If market conditions change so as to cause a deterioration in the wholesalers' terms of trade then they will either re-position themselves, usually by identifying value-added services that they introduce into the market thus allowing them to maintain or increase their overall trading margins, or they will face the risk of decline and, ultimately, outright elimination from the market.

15. It is clear that the writing has long been on the wall both in this particular sector of the economy and in the business of distribution more generally. In the pharmaceutical sector it is common cause that there is a hitherto unprecedented effort by the purchasers of pharmaceutical products and by those who finance the purchase of these products to secure a decrease in their prices. The buyers have, in short, sought to counter-balance the power of pharmaceutical manufacturers. For instance, the formation of large pharmacy chains such as Pharmicare, Hyperpharm, Dischem and Galleria are, in large part, inspired by an effort to constrain the prices of pharmaceutical products. In addition, increased monitoring of prices by managed health care organisations and medical aids as well as efforts through the formulary system, are all driven by the desire to constrain the pricing of pharmaceutical products. But this has also meant the entry of the large buyer into an area traditionally characterised by small retail pharmacies. These large purchasers are, like the state, perfectly capable of interfacing directly with the manufacturer. They do not, in other words, require the intermediation of the wholesaler.

16. This pressure to constrain their pricing behaviour has also caused the pharmaceutical manufacturers to focus on costs incurred in the chain of manufacturing and distribution and this, too, explains their increased attention to the mode of distributing their products. In other words, there is no doubt that the manufacturers, pressured to constrain their own pricing, will look to decrease costs and to appropriate pockets of profit in the value chain. They have clearly decided that there are costs that can be squeezed out of the distribution chain and/or that there are profits to be appropriated in undertaking this function differently to the traditional wholesaler model. There is, however, nothing necessarily sinister about this albeit that it may reverberate to the detriment of established pharmaceutical wholesalers – it is simply part of the competitive process, a process that we are charged with promoting rather than reifying.

3. Assessment of alleged restrictive practices

17. As noted the wholesalers alleged contraventions of Section 4 (restrictive horizontal practices), Section 5 (restrictive vertical practices) as well as certain subsections of Section 8 (abuse of a dominant position). This summary will only deal with the allegations in terms of Sections 5 and 8.

3.1 *The relevant markets*

18. There are, in our view, two relevant markets implicated in this matter. The first is, strictly speaking, not a single market but a set of distinct markets. Given that a pharmaceutical product intended for one therapeutic use cannot be substituted by a product intended for another therapeutic use, anti-trust investigations of the pharmaceutical industry tend to use the ATC3 therapeutic categories as the bases for identifying the relevant pharmaceutical product markets. The important point to underline is that there can be no aggregation of pharmaceutical products into a single pharmaceutical product market.

19. It is argued that the second market is that for the distribution of pharmaceutical products. This is the market in which Kinesis is said to compete with the applicants, although, as we elaborate below, the wholesalers also argue that the manufacturers and wholesalers are competing in the distribution market.

20. A number of caveats are in order. In particular we are not persuaded that there is a separate market for the distribution of *pharmaceutical* products. On the face of it, it is arguable that the market is that for the provision of distribution services, rather than *pharmaceutical* distribution services. As we elaborate below, this has a major, even dispositive, impact on the applicants' allegations relating to foreclosure.

21. Moreover, the applicants contend that the manufacturers and wholesalers compete in this distribution market, or, at any rate, in what the applicants identify in their heads of argument as 'the relevant markets for the sale of products to retail pharmacies and to medical practitioners'. The gist of this argument seems to be that whereas previously only the wholesalers enjoyed direct access to the manufacturers, this has now been extended to retailers and medical practitioners as well. Because, under this new regime, both manufacturers and wholesalers interact directly with retailers, they are somehow divined to be competitors in the same market 'for the sale of products to retail pharmacies and medical practitioners.'

22. We understand that the manufacturers have decided to interface directly, through their agent, Kinesis, with the retailers of their, that is, the manufacturers', own products. We are prepared to concede, with some residue of doubt, that this places both wholesalers and distribution agent in the same distribution market - notwithstanding that the former trades in pharmaceutical products and the latter trades in distribution and logistical services we concede that both do, in effect, distribute pharmaceutical products. However, we cannot agree that this places the manufacturers and distributors in the same market. Even if the manufacturers had elected to perform all the distribution functions in-house, that is, through a fully vertically integrated distribution division, this would not make them competitors in the distribution market any more than performing security functions in-house would make them participants in the security services market. There is no iron law that says that the manufacturing process begins and ends at pre-ordained points, much less that it is illegitimate from a competition perspective for the manufacturer to engage in any activity beyond those points. The products belong to the manufacturers and our starting point is that they are entitled to distribute it to their various customers as they see fit, just as they are entitled to secure their premises as they see fit. Indeed, if the wholesalers were to permit the general public to purchase products directly from their premises, the retailers would have no recourse under competition law.

23. In fact, in this case, the manufacturers have not taken distribution services in-house – they have simply elected to determine price in a direct interface with the retailers and, in certain, but not all, instances they have decided that they will offer a uniform price regardless of the purchasers designation as ‘wholesaler’ or ‘retailer’. Most of the physical acts associated with the task of ensuring that their products arrive at the purchasers’ premises have been contracted out to a specialist provider of distribution services. If the wholesalers compete with anybody in this scheme then it is with the distribution agent and certainly not with the manufacturer. In short, further argument and evidence may well reveal that the wholesalers participate in the pharmaceutical wholesale market which, like the erstwhile market for typewriters, is in terminal decline, not because of a restrictive practice perpetrated by a customer or a competitor but because a wholly new product, a wholly new mode of distribution, has displaced it.

24. In summary, then, we conclude that there is a range of separate pharmaceutical product markets based on ATC3 categories. The distribution market is more difficult to identify with confidence on the basis of the evidence before us. Conventional wisdom appears to concede the existence of a market for the distribution of pharmaceutical products. However, as noted, we are not persuaded that a broader definition of this market is not appropriate.

3.2 Restrictive vertical agreements

3.2.1 Section 5(1) of the Act provides:

- An agreement between parties in a vertical relationship is prohibited if it has the effect of substantially preventing or lessening competition in a market, unless a party to the agreement can prove that any technological, efficiency or other pro-competitive gain resulting from that agreement outweighs that effect.”

25. In this matter it is alleged that the respondents, by entering into contracts to establish an exclusive distribution agency, have fatally compromised intra-brand competition, competition between alternative sellers of the same brand. This, argue the applicants, should be of particular concern to the competition authorities because, it is alleged, it takes place in the context of an industry noted for the absence of inter-brand competition, competition between producers of alternative brands.

26. It is also alleged that the EDA effectively constitutes a barrier to new entry at the manufacturing level. Full-line wholesalers will, it is alleged, not be able to continue in business if they are not able to trade in the full range of pharmaceutical products. This means that pharmaceutical distribution will be dominated by agencies all in the exclusive service of active participants in the industry. Any would-be new entrant would then either have to persuade its competitors to undertake distribution on its behalf or, alternatively, face the formidable hurdle of entering at the distribution and manufacturing levels simultaneously.

27. In general, in order to sustain this allegation of likely foreclosure we would have to be persuaded that Kinesis is dominant in the pharmaceutical distribution market – which is manifestly not the case – or that it has entered into a conspiracy with the other EDAs. There is no evidence of such a conspiracy. But even this would not suffice to persuade us. There are other pharmaceutical distribution mechanisms in place, other, that is, than the various EDAs, to be found not least of all in the ranks of the present applicants. Moreover, as we have already indicated in our discussion of the relevant market, we have no reason to believe that other distributors, that is, providers of distribution and other logistic services in other sectors of the economy, would not be able to effect the distribution of pharmaceutical products. There are, we acknowledge, particular unique features that attach to the distribution of pharmaceutical products, but this applies to a range of products – fresh and frozen food products with their cold chain requirements is a pertinent example - and these have not precluded specialist logistic providers from meeting the

requirements of manufacturers of these products. For this reason we are yet to be persuaded that the relevant market for the purposes of our present examination is correctly identified as that for the provision of distribution services to the *pharmaceutical* industry.

28. The applicants counter that, whatever the theoretical prospects for new entry may be, this has not occurred for many years and that the allegedly low returns earned by the wholesalers are an effective deterrent to new entrants. Again, we are skeptical. Low returns may be endemic and permanent in the pharmaceutical wholesale trade. But this may be a signal that the wholesale mode of distribution has, like the typewriter, finally run into the sand. Wholesalers unwilling to grasp this nettle and reconsider their business model may well find themselves subject to endemically low returns. However, it is not for the competition authorities to protect them from their commercial folly. Certainly, as the present case exemplifies, there has been new entry by providers of logistic and distribution services. In other words, low returns may well be the outcome of a comfortable oligopoly whose participants are content with the easy life, with passing on pharmaceutical products and the associated margins to their long-standing and, it frequently appears, captive customers. Low returns are not necessarily indicative of robust competition.

29. We should note a feature of the exclusivity that attaches to this particular EDA. Certainly, Kinesis is exclusively contracted to perform a range of distribution and logistical services on behalf of its principals. But this does not preclude wholesalers from procuring product through the agency of Kinesis for on-sale to the retailers. Nor, naturally, are the retailers precluded from sourcing the principals' product through the wholesale channel. The wholesalers argue that by establishing an identical price for retailers and wholesalers any possible incentive for retailers to purchase their requirements from the wholesalers has been eliminated – the wholesalers would either have to charge the retailers a higher price than that available through the EDA or they would have to forego all margin. But this seemingly self-evident contention requires considerably closer scrutiny. Certainly, it is common cause that certain of the respondents still maintain an explicit price differential between its wholesale customers and its retail customers and that others continue to incentivise high volume purchases.

30. However even if we assumed that wholesalers and retailers were in fact charged an identical price, does this serve to eliminate the possibility of other pro-competitive offerings from the wholesalers? For example, the wholesalers insist that the full-line service that they offer is a convenient alternative for small retailers who, in the absence of such an offering, would have to place orders with a number of different EDAs. If this is indeed so, then why are wholesalers not able to charge for the convenience of one-stop purchasing? The greater frequency of the deliveries from the wholesalers is also presented as one of their competitive strengths. In other words, the EDA does not preclude the wholesalers from inserting themselves between the principals and their retail customers. However the test for a successful and sustainable pro-competitive insertion is that the wholesalers provide a pro-competitive rationale for their existence. If these additional offerings cannot be charged out, then it is clear that they are not valued by the market. It is not then for the competition authorities to foist these upon the market by providing that the wholesalers' position be secured through the provision of a price advantage.

31. Secondly, we have to examine the contention that the EDA has eliminated vigorous intra-brand competition, that is, competition between wholesale distributors of the identical pharmaceutical brand. Exclusive distribution arrangements do, per definition, eliminate intra-brand competition. However, there is insufficient evidence of vigorous competition between wholesalers (that is, intra-brand competition) in the pre-EDA era to sustain the allegation that this amounts to a substantial lessening of competition. We are asked to infer high levels of competition between the various wholesalers from the allegedly low returns earned by the latter. However, as already noted, this may well be indicative of a monopolist or a group of co-operating oligopolists who value the quiet life over and above high returns.

32. This latter interpretation is supported by other prima facie evidence of co-operation, rather than vigorous competition, between the wholesalers, the uniform discount demanded from the manufactures not the least of these indicators.

33. In the face of these prima facie indicators of co-operation as well as evidence submitted by the respondents we are not able to accept, without further evidence, the complainants' bald assertion of strong intra-brand competition for pharmaceutical products in the pre-EDA era.

34. We should also note the argument, widely supported in contemporary competition analysis, that holds that insofar as a diminution of intra-brand competition occurs as a result of an exclusive distribution arrangement, that this will be likely compensated for by more intensive inter-brand competition, that is, by competition between competing brands – in other words, that the distributor's focus on procuring competitive advantage for its clients brands will intensify competition with brands that do not enjoy the services of the distribution agent.

35. In opposition to this argument, the applicants contend that the pharmaceutical industry is characterised by unusually low levels of inter-brand competition. This contention appears to derive from two features associated with the market for pharmaceutical products. These are, first, the widespread use of intellectual property protection of pharmaceutical products. And, second, the 'must-have' nature of the product, the fact that product and brand selection of pharmaceutical products is made by the prescribing doctor thus eliminating the ability of the actual purchaser of the product to exercise any competitive choice.

36. We, of course, acknowledge ubiquitous use of patents in this sector. We note, however, the respondents' observation that even many patent protected products face competition from products applicable for the same broad therapeutic purpose. Moreover, we are constrained to observe that on closer appraisal of the evidence, the market for ethical pharmaceutical products may well be an innovation market, that is, that competition occurs in the innovation stage of the product life-cycle. This latter form of competition is not diminished by patent protection – indeed, it is competition in order to achieve patent protection in respect of a new innovation. The evidence before us does not justify a far-reaching judgment on the state of competition in the market for pharmaceutical products. We stress that further evidence and argument may well establish low levels of inter-brand competition in the pharmaceutical products market – certainly the exceptional returns posted by the pharmaceutical majors suggest low levels of competition. However, this conclusion cannot be justified on the papers submitted in this application for interim relief.

37. Even the 'must-have' nature of pharmaceutical product consumption has been called into question by relatively recent developments that have been highlighted by the respondents. We refer, of course, to increasing evidence of demand side buying power supported by legislative intervention that requires the use, under a range of circumstances, of cheaper products than those frequently prescribed by the consumer's doctor, as well as increasing pressure from medical aid schemes to contain costs.

38. In summary then, based on general pharmaceutical product characteristics – the widespread use of patent protection and the 'must-have' nature of the product – the applicants argue that inter-brand competition is already considerably muted and that the formation of an EDA will eliminate intra-brand competition. However, contrary evidence submitted by the respondents suggests that intra-brand competition has never been particularly strong and that inter-brand competition may well be a great deal more robust than suggested by the applicants.

39. In the absence of further evidence, we accordingly cannot find that the vertical agreement between the respective principals and the distribution agencies as represented by three EDAs in question

has resulted in a substantial preventing or lessening of competition in any of the relevant markets implicated in this matter.

3.3 *Abuse of Dominance*

40. The applicants also allege contravention of Sections 8 (a), (b) (c) and (d) (i). These contraventions would all constitute an abuse of a dominant provision.

3.3.1 *Dominance*

41. The threshold necessary to sustain an allegation of abuse of dominance is that dominance in a market should be established. It is here that the complainants' difficulties begin.

3.3.2 *Section 7 of the Act provides that:*

42. A firm is dominant in a market if:

- it has at least 45% of that market;
- it has at least 35%, but less than 45%, of that market, unless it can show that it does not have market power; or
- it has less than 35% of that market, but has market power.

43. Market power' is defined in the Act as:

'the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers.'

44. Recall that we have identified two relevant markets. The first refers to a set of pharmaceutical products markets each defined by the ATC3 therapeutic categories. The second refers to the market for the distribution of pharmaceutical products, although as we have noted above, there is prima facie evidence suggesting that the market may be cast more broadly as a market for the distribution of consumer products.

45. We can find no coherent allegation regarding dominance in the second of these markets, the distribution market. Accordingly our discussion of the abuse of dominance allegations is focused on the pharmaceutical product markets.

46. With respect to the pharmaceutical product markets, the applicants have produced therapeutic class analysis tables to establish that the principals collectively hold market shares in excess of 45% in 31 ATC 3 classes and market shares exceeding 35% in 3 other ATC 3 classes. On this basis they conclude that *"the principals are jointly dominant or presumed to be dominant (i.e. have more than a 35% share) in 31 ATC 3 classes."*

47. With respect to this allegation of 'joint dominance', the respondents counter that

"It is not sufficient to assert collective dominance (and we do not concede that the concept is recognised in our legislation) merely because the sum of the sales of the companies that use the same distributor is at least 35%. There can be no economic justification for aggregating sales in this way. Where GSK, Pfizer and Pharmicare products have similar therapeutic qualities they are competing products in a particular product market, properly defined, whether or not they use the same distribution agent."

48. We cannot but concur with the respondents. Even if we understand why a competition authority may elect to exercise particular vigilance towards a group of competing manufacturers using the same distribution agency - distribution being a particularly 'close to market' activity - the mere fact that they are doing so cannot be used to infer an agreement between the manufacturers and therefore cannot, of itself, infer 'joint' or 'collective' dominance for the purposes of sustaining a Section 8 allegation. Were we to permit this inference to be drawn we would expose every logistic or distribution service provider that had more than one client in the same market (as well as the clients themselves) to prosecution under Section 4 and, assuming that our Act does actually recognize the concept of abuse of *collective* dominance, Sections 8 and 9. In essence we would, by requiring that each provider of distribution services restrict itself to one client in each market, be severely inhibiting specialisation in the provision of these services. Indeed, the entire tenor of the applicants' arguments suggests that this is precisely the conclusion that they would have us draw.

49. In addition to 'joint dominance' the wholesalers allege that the manufacturers are individually dominant in a number of ATC3 categories.

50. The respondents, for their part, deny that dominance is proven in respect of the ATC 3 classes. They argue that in respect of certain products the manufacturer's patent may have expired, or other new innovative treatments may provide vigorous competition, or generic alternatives may be available. On this basis their expert report by Europe Economics, analyses the various markets and concludes that the degree of substitutability in the ATC 3 categories is such that the number of ATC 3 categories in which the respondents are dominant is relatively few.

51. The applicants, in addition to the evidence submitted on market share in the various therapeutic categories, allege, relying upon Section 7(c), that the respondents have market power.

52. In support of this allegation, the applicants insist, firstly, that the respondents' have the power to control price. This, they argue, is a consequence of patent protection and of the "must-have" nature of pharmaceutical products.

53. Clearly, patent protection confers a degree of monopoly power – this is its manifest intention. And while we have referred above to the submissions of the manufacturers in which they argue, inter alia, that even patented drugs are not immune from competition from other treatments in the same therapeutic category, there can be little denying the power conferred by a patent and the controversies surrounding the alleged willingness of the pharmaceutical manufactures to milk this power for all that it is worth. However, this having been said, it is indeed difficult to understand how the EDA confers 'additional' monopoly power on the patent holder. The source of the market power is the patent and this is not influenced by the distribution arrangement employed by the patent holder.

54. Secondly, the applicants argue that the principals have the power to behave independently of their customers and assert that this is evidenced by their unilateral alteration of the distribution pricing system and by the imposition of new trading terms and conditions via the EDA's. We will restate our response to this argument, which, although fundamentally flawed, constantly re-appears, in one guise or another, throughout the applicants' submissions.

55. The view supported by the applicants – and accepted for the purposes of this decision – is that the wholesalers and the logistic and distribution services specialists like Tibbet and Britten perform a distribution service for the pharmaceutical manufacturers. This is the basis of the applicants' insistence that they be rewarded for rendering this distribution service. The respondents, for their part, have decided to utilize the services of Kinesis, Tibbet and Britten's subsidiary. They have entered into a contract with Kinesis that appoints them their exclusive distribution agent. This is no different to appointing, on an

exclusive basis, a firm of auditors or attorneys or an advertising agent or a security company. During the contract period alternative firms of, for example, auditors will not expect to perform an auditing function for the entity in question and they will naturally not expect to be rewarded. Indeed the only basis for the applicants' insistence that, in the face of the EDA, they continue to perform distribution services and that they be 'rewarded' for so doing is that, in fact, they are, in reality, not providers of distribution services at all, but they are rather traders in, inter alia, pharmaceutical products. What has changed is not the 'reward' offered to them for performing the distribution service, but rather their terms of trade, terms that now include the cost of the distribution and other related logistical services, costs which have been internalised by the respondents in the form of an exclusive agency agreement with Kinesis.

56. The applicants are, of course, perfectly at liberty to continue as traders of pharmaceutical products. To do this may well pre-suppose that they improve their terms of trade that they bargain down the price charged by the manufacturers and/or bargain up the price they receive from the retailers. In order to improve their bargaining position they may, in turn, have to incorporate new services into their trading activities. But why should their inability to achieve more favourable terms of trade be construed as a manifestation of market power on the part of the manufacturers?

57. The mere selection by the manufacturers of a distribution agent does obviously not, in itself, reflect market power. Monopolistic market power would be manifest if a purchaser of distribution services were able to extract a sub-competitive price for the provision of these services. But there is no evidence for this, nor could there be. If the respondents insisted upon Kinesis delivering a competitive service at a sub-competitive price, then Kinesis would be at liberty to refuse the business and to compete for the distribution business of other pharmaceutical manufacturers, or, indeed, of manufacturers of any number of other products if the distribution market was defined broadly. The custom of the pharmaceutical manufacturers is undoubtedly incentive for the distribution service providers to bargain hard, to attempt to reduce costs in order to maintain a viable return and to introduce new and better services. But if, in the end, they are unable to agree on an acceptable rate and/or level of service, then the manufacturer would seek out another service provider and the distributor would seek out another purchaser of its services.

58. The wholesalers appear to contend that it is the exclusive element that manifests market power. But this too is untenable. There is an element of 'exclusivity' in every transaction – once I elect to purchase a motorcar, or, for that matter, the week's groceries, from a particular vendor, and then other vendors are 'excluded'. I will have been induced to support the chosen vendor by the superiority of her offering. This is why it has been recognised, from the earliest days of US anti-trust jurisprudence, that every contract contains an implicit 'restraint of trade' and this is precisely why the sweeping language of the Sherman Act has been moderated by a rule of reason. It was recognised that a literal interpretation of the Sherman Act's prohibition of every contract in restraint of trade would have the perverse consequence of restraining the operation of the market itself, rather than the anticompetitive conduct at which it was directed.

59. The principle outlined above is not affected by the fact that the commodity in question here is a service which is provided over a period of time, rather than a product supplied at a particular point in time. Exclusivity in the provision of the service, in particular the length of time for which it is granted, is simply part of the bargain. It takes no great insight to imagine the service provider conceding a lower price or a higher level of service in exchange for greater certainty in the form, on this occasion, of a time bound exclusive arrangement. In the normal conduct of trade these bargains are entered into every minute of every day. Certainly, as soon as the bargain is struck others are 'excluded', are 'restrained' from trading to a greater or lesser extent.

3.3.3 *Abuse*

60. Even if we proceed on the basis that one or other of the respondents ‘individually’ dominate 27 (founding affidavit) or 37 (replying affidavit) pharmaceutical product markets, the applicants would still have to establish that this dominance had been abused.

3.3.4 *Section 8 of the Act provides:*

61. It is prohibited for a dominant firm to:

- (a) charge an excessive price to the detriment of consumers;
- (b) refuse to give a competitor access to an essential facility when it is economically feasible to do so;
- (c) engage in an exclusionary act, other than an act listed in paragraph (d), if the anticompetitive effect of that act outweighs its technological, efficiency or other pro-competitive gain; or
- (d) engage in any of the following exclusionary acts, unless the firm concerned can show technological, efficiency or other pro-competitive gains which outweigh the anticompetitive effects of its act -
 - (i) requiring or inducing a supplier or customer to not deal with a competitor;...

62. The applicants Heads of Argument indicate that they are only pursuing abuse of dominance allegations under sections 8(d)(i) and 8(c).

3.3.5 *Section 8(d)(i)*

63. The wholesalers allege that the respondents are inducing each other, alternatively retail pharmacists and doctors, not to deal with the wholesalers, but with Kinesis.

64. In their Heads of Argument they state that:

“The Principals have perpetrated an abuse of dominance by compelling or at least inducing the Complainant’s customers to buy directly from them by offering them prices and/or discounts that the Applicants cannot match”

65. The respondents point out that the applicants have not established that they are competitors of the respondents, as envisaged by this section. They argue that pharmacists will choose to source product either from the manufacturers or the wholesalers on the basis of the distribution services offered, therefore, they compete in respect of the distribution service – not in respect of pharmaceutical products supplied. In this sense, the wholesalers and manufacturers compete at different levels of the supply chain, the wholesalers exerting no constraining force on the manufacturers at the product level, that is, in setting prices. They furthermore argue that “induce” cannot be interpreted broadly to include any manner of offering discounts based on volume of products purchased. We agree with this argument. More is required in terms of this section. It is the very essence of competition for competitors to compete for custom on the basis of superior offerings.

3.3.6 *Section 8(c)*

66. It is not clear from their papers whether the applicants are relying on the general species of exclusionary conduct in section 8(c).

67. In their Heads of Argument they state that:

“The Respondents, with effect from 29 May 2000, effectively refused to supply their products to the Applicants at the customary discounted rate, or at any price which would compensate the wholesalers for the services they render or to enable them to compete effectively with the Principals in the sale of their products. As their products are no longer offered to wholesalers on terms and conditions that make it viable for wholesalers to trade in such products. This is tantamount to a refusal to deal because the concept of a refusal to deal covers not only pure refusal, but also where a dominant company is only willing to deal on an unreasonable basis...”

68. From their assertions in their Heads, it seems the applicants are seeking to encapsulate under this section their allegations that the manufacturers are denying them competitive access to their products; raising the barriers to entry into the distribution market; and ensuring that their accounts are paid for in preference to other creditors.

69. The respondents argue once again, that the applicants have not established, even on a prima facie basis, the markets in respect of which the respondents are dominant. They also insist that the evidence before us shows there are a number of efficiency and pro-competitive gains which arise from the use of the EDA.

70. It is not clear to us that the respondents’ conduct is exclusionary. The applicants are clearly able to continue trading profitably in the respondents’ products and the effluxion of time has demonstrated that they have not been ousted from the market. This point is elaborated on later in the decision. We refer to our decision in York Timbers Limited and Safcol Limited:

“As already elaborated, we are not persuaded that the practice complained of, the reduction in the guaranteed supply from Witklip, is 'exclusionary' within the meaning of the Act - that is, it does not impede or prevent the applicant from expanding in the market but merely requires that it competes for its supply of raw material on terms similar to those available to its competitors. Moreover, even if the practice complained of were to be established as an impediment to the applicant's expansion in the market, it still remains for the applicant to establish the 'anticompetitive effect' of the practice, to show, in other words, that market power has been created or extended in consequence of the alleged act. This has not been done.”

71. Our reasoning in the York case is applicable here.